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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation	)	CC Docket No. 92-135
	)	
	)	

COMMENTS OF THE

NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

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SUMMARY

NTCA submits these Comments in response to the Commission's rulemaking on proposed regulatory changes for the treatment of small and mid-sized LECs. NTCA commends the Commission for its efforts to find ways in which regulation can be adapted to meet the changing structure of the telecommunications industry. NTCA appreciates the commitment to explore streamlining regulatory reform for small LECs. Moreover, NTCA acknowledges and thanks the Commission and its staff for seeking input from and working closely with NTCA and its small-LEC members to help shape regulatory proposals that are sensitive to the unique circumstances of these telcos. NTCA pledges to continue to work closely with the staff on this and future proceedings.

NTCA recommends several specific actions that the Commission should take to reform the regulatory treatment of the smallest LECs. First, the "Optional Incentive Regulation" plan, with minor modifications, is a reasonable proposal and should be adopted. Similarly, the proposal to extend the Section 61.39 small-LEC tariff filing rules to include common line rates is equally reasonable and should be adopted. The merger and acquisition provisions should be modified to be consistent with the rules adopted for pooling status.

Regarding "baseline" carriers and the NECA pools, NTCA recommends that ratemaking methods need to remain flexible so that LECs and the pools are not restricted in their ability to recover their costs or earn their authorized rate of return.

Also, the Commission should adopt streamlining approaches for the tariffing of new services. Finally, baseline LECs and NECA need access pricing flexibility just as the other carriers, and the provisions adopted for incentive-based plans should be extended to the rest of the industry.

NECA should be given the flexibility to design and implement optional incentive plans for the pools. This can be achieved by removing strict regulation of the settlements side of the NECA process. NECA should also be allowed to develop the conditions under which more LECs can receive settlements under Average Schedules, with options to change between forms of settlements subject to size and frequency restrictions.

Over the last decade, small LECs have become increasingly burdened by regulation and this trend should be reversed. The proposed incentive options may hold promise for reducing regulatory burdens, but more substantive deregulatory changes would be preferable.

Small LECs already have effective incentives to use resources prudently and efficiently and to provide quality service to their subscribers and connecting IXCs. Current forms of regulation do not necessarily lead to efficiency disincentives that need to be corrected. Finally, incentive plans based on measures of productivity that depend heavily on demand experience are not suitable to all LECs and should not be made mandatory.

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COMMENTS OF THE NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

The National Telephone Cooperative Association ("NTCA") submits these Comments in response to the Notice of Proposed Rulemaking released by the Commission on July 17, 1992, in the above-captioned proceeding ("NPRM"). By this NPRM, the Commission is proposing regulatory changes to the treatment of interstate services provided by small and mid-sized local exchange carriers ("LECs") that are not subject to the price-cap system applicable to the largest LECs. NTCA is a national association of approximately 480 small and rural LECs providing telecommunications services to interexchange carriers ("IXCs") and subscribers across rural America.

I. REGULATORY REFORM MUST REVERSE THE TREND OF THE LAST SEVERAL YEARS DURING WHICH TIME SMALL LECs HAVE BECOME INCREASINGLY BURDENED BY REGULATION.

NTCA applauds the Commission for its commitment to explore ways to adapt regulation to the changing communications industry structure, and more specifically to explore regulatory reform that recognizes the unique circumstances of small LECs. NTCA acknowledges and appreciates the earnest efforts of the Commission and its staff to seek input and work closely with the small LEC industry in formulating its proposals. NTCA commits to continued cooperation with the Commission as this proceeding continues, and beyond, to seek further appropriate regulatory reforms for the small and mid-sized carriers.

NTCA agrees with the Commission that the non-price cap group of LECs needs regulatory reforms. Since 1984, and the introduction of the access charge plan, the regulatory treatment of the smallest telcos has seen tremendous increases in the level and scope of intervention that directly affects small LECs in terms of administrative costs and straining their available resources. This trend is distressing, frustrating, and ironic to NTCA members, particularly since the industry appears to be moving in a direction towards less regulation. More competition and more regulation, at the same time, have created a most burdensome, worst-of-all-worlds condition for the smallest telcos.

History does not support the levels of burdensome, and in some cases, needless and purposeless regulation. Small telcos operated for nearly a hundred years without any substantial federal regulation. During that one hundred years, the industry flourished; tremendous strides were made towards achieving Universal Service, and the quality of service including that provided by the smallest telcos reached levels of excellence revered by the entire world. Only the last nine out of a hundred years of this history have small LECs operated under federal regulation.

Judging from history, the Commission should consider more meaningful changes to relax regulation of the smallest LECs, more in line with the experience of the first 90 years prior to 1984. The current levels of administrative costs that arise under current regulation are for both the federal government and the small, rural telcos far greater than any societal benefits derived from this activity. Many states have arrived at this conclusion and have, in several slightly varying degrees, virtually deregulated the operations of the smallest carriers in their states. Some of these deregulatory initiatives have been underway for several years without any major problems. NTCA urges the Commission to look to these state plans for assurance that the federal jurisdiction may safely pursue deregulatory options for the smallest LECs. While the continuum of incentive options that the Commission has proposed may hold some small promise of reducing regulatory burdens, more substantive deregulatory changes would be preferable.[1]

II. REGULATORY PROPOSALS BASED ON PRODUCTIVITY MEASURES THAT DEPEND HEAVILY ON ACCESS DEMAND ARE NOT SUITABLE FOR SOME SMALL LECs AND SHOULD NOT BE MANDATORY.

The Commission's incentive regulation initiatives of recent years depend on measurements of carriers' cost per demand. However, LECs only have control over the numerator portion of

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[1] In reflecting on the relative market size of the non-price cap LECs, Chairman Sikes agreed that there is a disproportionate regulatory approach towards the small LECs: "[You] simply don't need the same cage for a canary as you use for a gorilla." Oral statement by Chairman Alfred Sikes, Open Meeting of June 18, 1992.

this quotient.[2] Incentive regulation plans which apply broad or average cost/demand quotients that depend on increases in demand as a measure of relative efficiency place small LECs in an unacceptably risky position. The risk potential exists because small LECs can experience relatively large and unpredictable variance in demand from year to year which has little or nothing to do with efficiency or productivity. Large averaged or constant cost/demand quotients are not representative of the actual experience of small geographic areas.

The Commission correctly acknowledges that the "size, diversity, and regulatory history" of the group of approximately 1300 of the smallest LECs "presents substantial challenges to designing incentive-based regulatory reforms."[3] These telcos are small from a statistical standpoint. They are often concentrated geographically and the residences and businesses served may be substantially dependent on a single industry, single employer, or single local business. Any change in that industry, employer, or business can have a dramatic impact on

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[2] Even the cost numerator of this calculation is not entirely within the control of the LEC. For example, NTCA's member LECs are obligated to provide Universal Service and are committed to providing quality service to rural America on a reasonably equal level to the services available in urban areas. Therefore, these telcos' costs are subject to the geographic and demographic determinations of their cost which are unrelated to the efficiency with which they construct and operate facilities. LECs may also be obligated by specific regulation to provide specific services such as equal access and 800 Data Base. While small LECs may find these services beneficial in the long run, they are obligated to incur the costs of these services according to the Commission's schedule for deployment.

[3] NPRM at para. 2.

access demand. Also, the loss of even a single, large business customer which may be responsible for a large percentage of interstate access usage may dramatically alter the telco's remaining cost per demand. Faced with a dramatic decline in demand, small LECs need cost recovery options that recognize these possibilities in order for service to remain economically viable to rural subscribers. The collection of proposals of recent years described as incentive plans do not provide the necessary cost recovery flexibility for telcos that may find themselves in these undesirable situations.[4]

The use of a single cost per demand measure, either to gauge productivity or used in the mechanics to provide efficiency incentives, is too narrow an approach to be applied to all small companies. The small company faced with a customer base dependent on a declining industry or a general community population decline may exhibit large increases in service costs per demand. Nevertheless, the management of this telco may be doing a superb job of managing the situation as efficiently as possible. The management may be taking all the right actions to preserve quality service and to operate efficiently under the circumstances. To evaluate the efficiency or productivity of

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[4] NTCA has explained several times before why price cap plans are not universally adaptable to some small LECs' operations. See, e.g., Comments filed by NTCA on July 26, 1988, in CC Docket No. 87-313 at 1-8; Reply Comments of NTCA filed September 9, 1988, in CC Docket No. 87-313 at 10; Reply Comments of NTCA filed August 3, 1989, in CC Docket No. 87-313 at 2-4; and Comments of NTCA filed May 7, 1990, in CC Docket No. 87-313 at 3-6.

this company, a multitude of factors, many of which are not numerically quantifiable in terms of formulas and indices must naturally be considered.[5]

The point to this discussion is that the incentive plans that have been proposed to date are not universally adaptable to all LECs. The mandatory application of price indices or relative cost per service demand constraints on some LECs will lead to unintended and perverse incentives and undesirable effects. Unique characteristics associated with small telcos and sparsely populated service territories lead to Universal Service challenges that make the cost/demand incentive proposals unsuitable to many small telcos. If some small telcos were forced to submit to an inappropriate form of regulatory treatment, then the subscribers of these telcos could suffer as the result of the cost recovery restraints. Facing such cost recovery restrictions, small LECs may be provided with perverse and inescapable incentives to degrade their local network, a result that, no matter what the reward or penalty, NTCA members will not accept. Currently designed incentive proposals must not be made mandatory. Perhaps, other incentive-based proposals that

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[5] Many of these factors are subjective and highly debatable. An historical example from the past decade or so is the debate that arose over the question of what point in time it was prudent for telcos to convert specific switches to digital technology. Even hindsight does not conclusively provide any absolute, ideal answer to this debate. These debates many times reduce to the question of, given the cost of providing a service, is it in the public interest for a specific service to be available to subscribers. Incentives based on cost per demand do not answer these difficult questions.

address the complex situations of small LECs can be designed and analyzed, but current traditional regulatory treatment options may have to be continued for a long time. Therefore, NTCA urges the Commission to recognize that incentive regulation, as currently formulated, must remain optional so that small LECs with unique circumstances can address their own cost recovery needs.

III. SMALL LECs ALREADY HAVE EFFECTIVE INCENTIVES TO USE RESOURCES PRUDENTLY AND EFFICIENTLY AND TO PROVIDE QUALITY SERVICE TO THEIR SUBSCRIBERS AND IXCs.

The Commission's incentive-based regulatory reform proposals of recent years are explicitly based on the proposition that the traditional rate-base, rate-of-return, cost-of-service form of regulation is inferior to the incentive type plans. This proposition is not an absolute that holds true in every circumstance or for every LEC. When service is viewed in terms of commitment to Universal Service, deployment of advanced technology, service quality, and genuine responsiveness to customers' needs, the small and rural LEC industry has an exemplary record under the current form of regulation. The recently proposed regulatory reforms are constructed to provide incentives to cut costs to match the revenues received according to capped or frozen prices. Traditional forms of regulation allow LECs to provide quality service at the reasonably necessary cost. Each approach has its own advantages and disadvantages which differ depending on public policy objectives and individual situations.

Non-urban telcos have fought for decades to establish the necessary industry structure which allows them to provide comparably equal quality and availability of services as customers are afforded in highly-populated areas. The small and rural NTCA member LECs have been in the forefront in the development of state-of-the-art technologies.[6] This level of service achievement does not come without cost and price challenges.

Locally-controlled and operated telcos show a commitment and responsiveness to their customers. Many state public service commissions report high marks for quality of service for the smallest LECs as evidenced by maintenance and installation activities.[7] Moreover, the local influence already exercises control over telcos which provides incentives to reach the proper balance between quality and cost.[8] In some states, the

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[6] See, Statement of Common Carrier Bureau Chief Cheryl Tritt: "There's another interesting twist to this. The smaller companies are really more technically advanced in the aggregate than the larger carriers." Open Meeting of June 18, 1992, in response to questions from the Commissioners. See, also, Comments of NTCA and OPASTCO in NTIA, Notice of Inquiry on Infrastructure, Docket No. 91296-9292; and NECA's Access Market Survey results, released June 1992, titled Modernizing Rural America -- Investments in new technologies by small telephone companies.

[7] See, Statement of Common Carrier Bureau Chief Cheryl Tritt: ". . . [O]ur information from state PUCs indicate that the maintenance and installation levels for the small carriers are very good and sometimes even exceed the larger carriers." Open Meeting of June 18, 1992, in response to questions from the Commissioners.

[8] See, Statement of Chairman Alfred Sikes: ". . . I do think often that small telephone companies outpace some of the (continued...)

operations of small and rural telcos are examined closely by public service commissions without any substantive findings of waste or mismanagement. These observations imply that many small LECs already have sufficient incentives to respond to their customers' needs in an efficient manner using a prudent choice of technological developments.

Current forms of regulation do not necessarily lead to the introduction of counter-productive efficiency disincentives that need to be corrected. Regulatory reform should improve on what we have, not simply abandon it in favor of theoretical alternatives that may or may not lead to improvements for society in every case.

IV. THE "OPTIONAL INCENTIVE REGULATION" PLAN, WITH MINOR MODIFICATIONS, IS REASONABLE AND SHOULD BE ADOPTED.

The Commission is proposing one specific option it has referred to as the Optional Incentive Regulation ("OIR") Plan.[9] This plan would be available to any non-price cap LEC that also does not participate in any NECA pool. The plan calls for two year tariff filings, greater reliance on historical cost and demand, broader earnings bands, and some pricing flexibility.[10] NTCA believes that the Commission should adopt this proposal for

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[8](...continued)
larger phone companies and do believe it is because you can't get away from your customers." Open Meeting of June 18, 1992, commenting on the observed benefits of local ownership and control.

[9] See, generally, NPRM at paras. 9-26.

[10] Id. at para. 9.

the expected small number of LECs that may decide on this option. The proposal represents one small step towards regulatory treatment options that involve less administrative burdens and should be made available.[11]

At least one modification to the OIR plan, however, is needed. The Commission is proposing a streamlined approach to setting initial rates for new services for carriers under the plan.[12] This proposal includes a provision that would allow a carrier to set a rate for a new service not to exceed the geographically closest, price-cap regulated LEC's rate for this service. This proposal seems unworkable because the closest price-cap carrier may have little in common with the affected LEC. Even the highest rate of neighboring price-cap LECs may be too low for the OIR plan carrier to recover its costs because of fundamental differences between the two types of carriers.[13] NTCA supports a new services pricing approach that looks to existing rates of the OIR carrier and indexes those rates to

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[11] NTCA also supports the Commission's tentative approach not to make a LEC's decision to opt for OIR irrevocable. NPRM at para. 26. NTCA also believes that OIR carriers should be allowed to reenter NECA pools should they decide to abandon the incentive plan at some point and return to a traditional form of regulation. However, these carriers should retain any Long Term Support obligation that they accepted when they exited the NECA pools.

[12] NPRM at para. 16.

[13] Notably, the rate for the price-cap carrier is developed based on costs and demand spread across both urban and rural areas, and the urban costs and demand characteristics substantially dictate the resulting rate. An OIR plan carrier will typically only serve lower density, higher cost areas.

known rates of price-cap carriers. This index could then be applied to price-cap LECs rates for the new service for purposes of establishing a maximum rate for the new service of the OIR plan carrier. The indexing approach is more likely to result in a rate that is consistent with cost recovery requirements of the LECs opting for the OIR plan.

V. THE PROPOSAL TO EXTEND THE SECTION 61.39 SMALL-LEC, HISTORICAL-FILING OPTION TO COMMON LINE IS REASONABLE AND SHOULD BE ADOPTED.

For similar reasons, NTCA also supports the extension of the Section 61.39 filing option to include common line rates in addition to the currently available option for traffic-sensitive rates. As stated above, NTCA supports relaxed regulation as a valuable reform that will benefit small LECs and the subscribers they serve. As long as proposals such as these do not overly threaten the continued availability of NECA pooling and Average Schedules, then regulation should be relaxed to the maximum degree consistent with the public interest. The current traffic-sensitive option has not threatened pooling or Average Schedules and, therefore, extending the option also should not introduce any substantial complications.

VI. THE COMMISSION SHOULD ADOPT A MORE FLEXIBLE APPROACH FOR THE TREATMENT OF CARRIERS UNDER "BASELINE" REGULATION AND NECA POOLING.

The Commission is examining whether tariff filings for carriers remaining under a traditional form of regulation should be less frequent and should rely to a greater degree on historical information and less on projected data.[14] While some LECs may be willing to live with these options, the Commission should not adopt rules that require rates to be developed according to these different methods. For some carriers and the NECA pool, the proposals could act to restrict their ability to recover their costs or earn their authorized rate of return. The dynamics of year-over-year cost changes and demand experience are complex for small LECs and the NECA pool. Therefore, methods should not be adopted as requirements that are less flexible than current tariff filing procedures.

NTCA also favors regulatory changes that would allow streamlined treatment of tariff filings by NECA or baseline carriers proposing new services. An approach similar to that proposed for the OIR plan above should be available to all baseline carriers and NECA. The streamlining should include a two percent revenue test and an indexing approach to establish a maximum rate.

The Commission has proposed a degree of pricing flexibility among access rates for the OIR plan.[15] NTCA suggests that a "basket" and "service category" approach also be available to the traditional rate of return carriers and NECA. These carriers have the same need to respond to relative changes in access charge rates. Therefore, the pricing flexibility components of

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[14] NPRM at paras. 43 and 44.

[15] NPRM at paras. 17-18.

the OIR plan should be extended to the rest of the non-price cap industry.[16]

VII. NECA SHOULD BE GIVEN THE OPPORTUNITY TO DEVELOP AN INCENTIVE DESIGNED PLAN FOR THE NECA POOLS.

NTCA agrees with the Commission that introducing incentive regulation within the NECA pools may be difficult.[17] However, this initially perceived difficulty should not discourage NECA from searching for workable options. Therefore, NTCA urges the Commission to grant NECA the opportunity to design a plan.

In keeping with NTCA's position outlined above urging the Commission to consider serious deregulation of small LECs, NECA should be afforded maximum flexibility to design a plan. The Commission suggests that one possible approach may be to have individual pool participants contract with the pool to receive, perhaps, pre-determined or fixed settlement amounts.[18] In keeping with this approach, NTCA recommends that the settlements side of NECA's pooling operation be deregulated so that NECA has the necessary flexibility to develop its own plan under the guidance of its own decision-making process. In other words, as long as rates charged to IXCs are not seriously affected, NECA should have the ability, without regulatory restraints, to

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[16] NTCA expects NECA, in its comments, to address its needs with respect to filing of tariffed rates. NECA will also comment on rate establishment methods for new services and pricing flexibility for the pools. These suggestions should, when applicable, apply to individual, non-pooling, rate-of-return carriers.

[17] NPRM at para. 47.

[18] Id.

distribute the available pooled revenues as it determines is most effective and beneficial to the pooling participants.

VIII. MORE TELCOS SHOULD BE ALLOWED TO RECEIVE SETTLEMENTS BASED ON INTERSTATE AVERAGE SCHEDULES.

NTCA believes that the benefits of the interstate Average Schedules form of settlement should be available to more small carriers. Average Schedules relieve small LECs from the expense and administrative burden of preparing cost studies. Average Schedules also include an incentive component of cost containment in that LECs are somewhat rewarded for keeping costs below settlements. Furthermore, the Commission has previously recognized the benefit of allowing small cost study LECs to convert to Average Schedule status.[19] Consistent with deregulation of the settlements side of the NECA operation, the objectives of this docket, and the earlier actions, the Commission should allow NECA to develop a rule which prescribes the conditions under which pooling LECs can receive settlements under interstate Average Schedules. Small LECs should have some options to convert from one form of settlement to the other subject to a size and frequency restriction.

IX. THE MERGER AND ACQUISITION PROVISIONS SHOULD BE CONSISTENT WITH THE POOLING STATUS RULES.

The Commission asks how the resulting entity from mergers and acquisitions between incentive plan carriers and non-

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[19] Order, In the Matter of NECA's Proposed Waiver of Section 69.605(c) of the Commission's Rules, CC Docket No. 78-72, Phase I, 2 FCC Rcd 3960 (1987); and Order, In the Matter of Petitions Seeking Average Schedules for Affiliated Cost Companies with 5,000 or Fewer Access Lines, 3 FCC Rcd 6003 (1988).

incentive plan carriers or portions of either should be treated.[20] NTCA urges the adoption of a similar rule as the Commission adopted in CC Docket 89-2.[21] This ruling was based on a joint industry filing which recommended that LECs be permitted to retain their pre-transaction pooling status after mergers or acquisitions.[22] Those rules require pooling status waivers only where carriers, as the result of an acquisition or merger, would be returning more than 50,000 access lines to pooling status. This same criteria should apply to mergers and acquisitions between incentive plan and non-incentive plan LECs. Specifically, under this approach, non-incentive plan carriers that acquire incentive plan carriers or portions of incentive plan carriers should be allowed to retain non-incentive plan status for the resulting entity, without waiver, subject to the

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[20] NPRM at para. 50. The Commission states that "[t]he issue now is whether an incentive plan carrier that subsequently acquires a non-incentive plan carrier should be required to convert the latter to the incentive plan." Id. But more importantly to NTCA members would be the continuing status of a non-incentive plan carrier that acquires an incentive plan carrier. Both possibilities present issues.

[21] Report and Order, In the Matter of Amendment of Part 69 of the Commission's Rules Relating to the Common Line Pool Status of Local Exchange Carriers Involved in Mergers or Acquisitions, released August 23, 1989, in CC Docket No. 89-2.

[22] See, Joint Comments of the National Rural Telecom Association, National Telephone Cooperative Association, Organization for the Protection and Advancement of Small Telephone Companies, and United States Telephone Association and the National Exchange Carrier Association, CC Docket 89-2, filed Feb. 19, 1989.

restriction that the access lines to be reverted are less than 50,000.[23]

X. CONCLUSION

The rules under review in this proceeding were enacted to apply to ratemaking and tariff actions of the largest LECs, and as such, are inconsistent with the needs and characteristics of the smaller LECs and the public interest's regulatory objectives. Therefore, NTCA agrees with the Commission that streamlining of regulatory treatment afforded baseline LECs and the NECA pools will yield valuable benefits. Furthermore, NTCA supports the Commission's initiative to find ways to adapt regulation to fit the circumstances and needs of the smaller LECs. NTCA urges the Commission to adopt the specific recommendations outlined above.

Respectfully submitted,

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23 See, also, Petition for Reconsideration of NTCA filed November 21, 1990, in CC Docket 87-313 at 12-14.

CERTIFICATE OF SERVICE

I, Rita H. Bolden, certify that a copy of the foregoing Comments of the National Telephone Cooperative Association in CC Docket No. 92-135 was served on this 28th day of August 1992, by first-class, U.S. Mail, postage prepaid, to the following persons listed below:

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